

**STATE OF UTAH INSURANCE DEPARTMENT
REPORT OF EXAMINATION**

OF

WASATCH CREST INSURANCE COMPANY

OF

SALT LAKE CITY, UTAH

As of

December 31, 1998

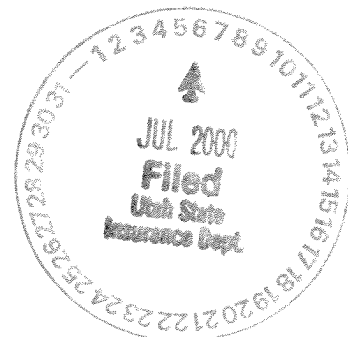


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Salt Lake City, Utah
April 27, 2000

Honorable Alfred W. Gross, Chairman
NAIC Financial Condition (EX4) Subcommittee
Insurance Commissioner
State of Virginia
Richmond, Virginia

Honorable Jose Montemayor
Secretary, Western Zone NAIC
Commissioner of Insurance
State of Texas
Austin, Texas

Honorable Merwin U. Stewart
Insurance Commissioner
State of Utah Insurance Department
Salt Lake City, Utah

Dear Sirs:

Pursuant to your instructions and in compliance with the insurance laws of the State of Utah, the rules and regulation of the Utah Insurance Department, and the policies and procedures adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the records, business affairs, and financial condition of the

WASATCH CREST INSURANCE COMPANY
Salt Lake City, Utah

hereinafter referred to as such or as the "Company."

SCOPE OF EXAMINATION

Period Covered

The Company was previously examined as of December 31, 1994, by representatives of the Utah Insurance Department. The current examination was conducted by representatives of the Utah Insurance Department and covered the period from January 1, 1995, to and including December 31, 1998, and included any material, subsequent transactions or events that were noted during the examination.

Procedures Employed

The examination included a general review and analysis of the Company's operations, the manner in which its business was conducted during the examination period, and a determination of its financial condition as of December 31, 1998. All phases of the examination were conducted to determine compliance with generally accepted regulatory accounting standards and procedures, and in accordance with the insurance laws of the State of Utah and the insurance rules promulgated by the Utah Insurance Department. Although the examination was full scope in nature, its purpose was not to detect anything of a fraudulent nature.

Status of Adverse Findings in Previous Report of Examination

Disclosures in the prior report of examination were resolved during the period under examination.

HISTORY

General

The Company was incorporated on September 30, 1886, under the laws of the Territory of Utah and commenced business in October 1886, under the name of Home Fire Insurance Company of Utah. In March 1918, the name was changed to Utah Home Fire Insurance Company. Over the years, the Corporation of the President of the Church of Jesus Christ of Latter-day Saints purchased control of the Company. On February 2, 1972, Deseret Management Corporation, a wholly owned subsidiary of the church, acquired controlling interest in the Company. On December 31, 1984, Beneficial Life Insurance Company (Beneficial) acquired 126,661 shares of the Company's stock from Deseret Management Corporation and bought 71,852 shares of authorized and un-issued stock of the company for \$125 per share. On February 7, 1985, Beneficial purchased an additional 538 shares. From 1985 through 1989, Beneficial acquired 944 shares from minority shareholders. On April 1, 1993, the Company executed a plan of recapitalization, under which Beneficial surrendered to the company 100,000 of the shares which it owned and \$7,000,000 in 1991 issued contribution notes. Deseret Management Corporation acquired a direct interest in the Company by exchanging its two surplus debentures in the amounts of \$90,000,000 and \$37,000,000 for 1,900,000 shares of the Company's common stock. In September 1993, Beneficial transferred its remaining 99,995 shares to Deseret Management Corporation.

Effective October 31, 1998, the Company was acquired by Wasatch Crest Group, Inc. from Deseret Management Corporation. Effective December 23, 1998, its name was changed from Utah Home Fire Insurance Company to Wasatch Crest Insurance Company.

Capital and Surplus

Effective December 31, 1998, the restated articles of incorporation set forth that the Company is authorized to issue one class of stock comprising 2,000,000 shares with a par value of \$10 per share. The number of shares outstanding were 225,000.

Dividends to Stockholders

The Company did not pay any dividends to stockholders during the period covered by this examination. A request was made November 25, 1997, by the former owners of the then Utah Home Fire Insurance Company for an extraordinary dividend. Utah Home Fire Insurance Company's unassigned surplus was negative. Because of this, the request was treated and approved as an extraordinary distribution of its gross paid in and contributed surplus in the amount of \$10,000,000.

Management

The restated articles of incorporation set forth, "The affairs of the Corporation shall be administered by a Board of Directors consisting of seven individuals."

Board of Directors

The following were serving as members of the board of directors as of December 31, 1998.

<u>Director</u>	<u>Mailing Address</u>	<u>Principal Occupation</u>
Orrin T. Colby Jr.	South Salt Lake City, Utah	Chairman of Board and Chief Executive Officer-Wasatch Crest Mutual Ins. Co. and affiliates
Gordon B. Boyle	Murray, Utah	President and Chief Operating Officer-Wasatch Crest Mutual Ins. Co. and affiliates
John A. Igoe	San Rafael, California	Chairman & CEO, LWP Commercial Claims Administrators, Inc.
Verl R. Topham	Salt Lake City, Utah	Senior Vice President and General Counsel, PacifiCorp
Richard A. Veed	Hinsdale, Illinois	Managing Partner AAM Capital Partners, LP
Steven W. Webersen	Chester, New Jersey	Principal, Securitas Capital, LLC
Harold C. Yancey	Centerville, Utah	Chairman of Board, Beneficial Life Insurance Company

Officers

Those officers elected by the board of directors and serving as of December 31, 1998, were:

<u>Name</u>	<u>Office</u>
Orrin T. Colby Jr.	Chairman and Chief Executive Officer
Gordon B. Boyle	President and Chief Operating Officer
William J. Worsley	Vice President-Finance, Secretary and Treasurer

Committees of Directors

Appointment of board committees as of December 31, 1998, were:

<u>Executive Committee</u>	<u>Audit Committee</u>
Orrin T. Colby Jr. - Chairman	Harold C. Yancey - Chairman
Richard A. Veed	Steven W. Webersen
Harold C. Yancey	Verl R. Topham

Investment Committee

Gordon B. Boyle - Chairman
Steven W. Webersen
John A. Igoe

Compensation Committee

Verl R. Topham - Chairman
Orrin T. Colby Jr.
John A. Igoe

Conflict of Interest

The Company had a written procedure for the disclosure to its board of directors of any conflict of interest or affiliation on the part of its officers and directors which is in or likely to conflict with the official duties of such person.

Corporate Records

A review was made of the corporate records for the period covered by this examination. The minutes reviewed indicated that the deliberation and actions of the various corporate bodies were in compliance with the Utah Insurance Code. The restated articles of incorporation were effective December 23, 1998, and were approved by the Utah Department of Insurance January 6, 1999.

Acquisitions, Mergers, Dissolutions, Purchases or Sales through Reinsurance

There were no acquisitions, mergers or similar transactions during the period of this examination.

AFFILIATED COMPANIES

As of December 31, 1998, the Company was a member of an insurance holding company system. Wasatch Crest Mutual Insurance Company was considered the ultimate controlling entity. The Company was 100% directly owned by Wasatch Crest Group, Inc.

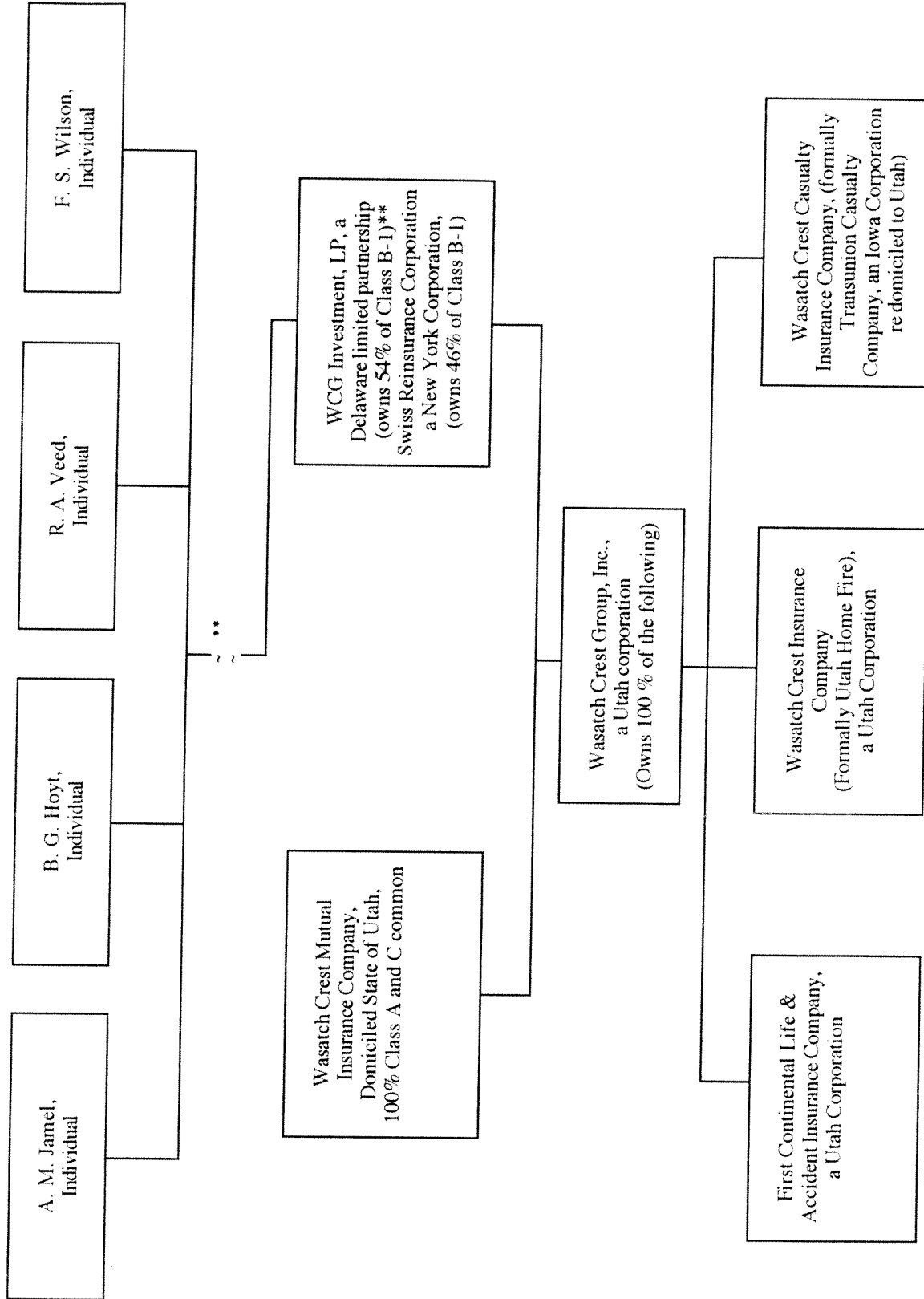
Wasatch Crest Group was owned as follows: Wasatch Crest Mutual owned 100% of the shares of Wasatch Crest Group's Class A and C common stock. Outside investors owned 100% of the issued Class B-1 and Class B-2 shares.

As of December 31, 1998, Wasatch Crest Mutual owned 1.0 million of Class A shares of Wasatch Crest Group or 34% of the voting rights, and 5.3 million of Class C shares, or 33% of the voting rights for a total of 67% of the voting rights. This gave Wasatch Crest Mutual control of Wasatch Crest Group. WCG Investment, LP owned 54% of the Class B-1 common and Swiss Reinsurance Corporation owned 46%, or 33% of the voting rights. Chase Equity Associates, LP owned 100% of the Class B-2 non-voting shares.

Wasatch Crest Mutual owned 6,300,000 common shares of the 21,000,000 shares issued and outstanding or 30% of Wasatch Crest Group.

Wasatch Crest Casualty Insurance Company, an affiliate, was a property and casualty insurance company licensed to write disability, property, liability, and workers compensation insurance in the State of Utah and assumed 95% of the black lung business of Wasatch Crest Mutual. First Continental Life & Accident Insurance Company, an affiliate, wrote group term life and medical stop loss coverage.

ORGANIZATIONAL CHART



**WCG Investment, LP, was controlled by a limited partnership whose general partner was VWA, L.L.C. VWA, L.L.C. was ultimately controlled by A.M. Jamel, B. G. Hoyt, R. A. Veed and F. G. Wilson

Statutory Reporting

The acquisition of the Company, then the Utah Home Fire Insurance Company was approved by the Utah Insurance Commissioner on October 22, 1998.

Management Agreements

There was an inter-company agreement executed October 31, 1998, between the Company and Wasatch Crest Mutual, whereby Wasatch Crest Mutual provided the necessary personnel, work space, equipment and electronic data processing services for use in connection with the Company's administrative, claims processing, accounting and other functions. The agreement stated that the costs and expenses will be allocated pursuant to the NAIC Uniform Classification of Expenses. The Company agreed to pay Wasatch Crest Mutual the cost of these services.

FIDELITY BOND AND OTHER INSURANCE

The Company was a named insured under several insurance policies, along with its parent and several affiliated companies.

There was a financial institution bond with an aggregate liability of \$1,000,000, subject to a single loss limit of liability of \$1,000,000 and a single loss deductible of \$25,000. The NAIC suggested minimum amount of fidelity insurance for a company of this size was \$75,000 to \$100,000.

The Company also participated in commercial lines, commercial catastrophe, and employment practices liability insurance. The directors and officers were provided a director's and officer's and company reimbursement policy. This policy had a \$100,000 retention for each claim. The limit was \$5,000,000. Overlying this policy was an excess director's and officer's and company reimbursement policy.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

All services necessary for the Company's operation as of December 31, 1998, were provided by Wasatch Crest Mutual. The Company did not have any employees.

STATUTORY DEPOSITS

To comply with the statutes of the various state insurance departments, the following securities were on deposit as of December 31, 1998.

<u>Type of Asset</u>	<u>Statement Value</u>	<u>Market Value</u>	<u>State</u>
Funds held not for the benefit of all policyholders:			
US Treasury Notes	\$ 299,231	\$ 303,000	Florida
Funds held for the benefit of all policyholders:			
US Treasury Notes	35,000	35,700	Georgia
Certificate of Deposits	100,000	100,000	Louisiana
US Treasury Notes	700,000	707,000	South Carolina
US Treasury Notes	<u>2,000,000</u>	<u>2,020,000</u>	Utah
Total	<u>\$3,135,000</u>	<u>\$3,165,700</u>	

The deposit with the Utah Insurance Department was in accordance with the requirements of UCA § 31A-4-105. The required deposit for this type of company was \$2,000,000.

INSURANCE PRODUCTS AND RELATED POLICIES

Policy Forms and Underwriting Practices

The Company, effective March 23, 1998, was authorized to transact the business of disability, property, liability, marine and transport, worker's compensation, vehicle liability, and professional liability insurance in the State of Utah. There were no policy forms to review.

Territory and Plan of Operation

The Company was licensed to do business in the following sixteen states: Alabama, Arizona, California, Colorado, Georgia, Hawaii, Idaho, Michigan, Nevada, New York, Oregon, South Carolina, Tennessee, Texas, Utah and Washington.

All of the Company's business is currently in a run-off mode. The lines of business written in the past by the Company included fire and allied lines, homeowners, commercial multiple peril, ocean marine, inland marine, earthquake, other liability, commercial auto liability, private passenger auto liability, commercial auto physical damage, private passenger auto physical damage.

The inland marine and earthquake business was written in conjunction with the Company's homeowners and commercial multiple peril programs. Other liability business was primarily composed of general liability for recreation risks, artisans, and real estate errors and omissions coverage. Effective January 1, 1996, the company ceded 100% of its Oregon private passenger business.

The Company (formally Utah Home Fire Insurance Company) experienced serious financial difficulties in 1992.

Advertising and Sales Material

Since the Company was acquired there has been no advertising.

Treatment of Policyholders

Claims were paid on a run-off basis. A test of claims paid revealed no exceptions to regulatory claims settlement practices. The Company did not have a formal system for control over policyholder complaints. There were no complaints filed with the Utah Insurance Department for the years covered by this examination.

REINSURANCE

Reinsurance Assumed

All reinsurance agreements on reinsurance assumed were terminated as of December 31, 1992, and as of the date of this report were in a runoff mode.

Reinsurance Ceded

All business written after January 1, 1993, by the former Utah Home Fire Insurance Company was ceded on a 80% quota share basis. Most of these agreements provided that the Company retain \$100,000. There were five catastrophe loss agreements for various years with limits of 50% of the amount over \$10,000,000.

Under previous management, the Company entered into a retroactive reinsurance contract, as a loss portfolio transfer agreement, with Signet Star Reinsurance Company to cover additional losses. The reinsurer is liable for all losses and allocated loss adjustment expenses paid, net of reinsurance recovered after December 31, 1996, relating to all of the Company's policies issued prior to January 1, 1997. This agreement provided coverage up to \$10,000,000. The cost of this coverage was \$7,895,000. Options for four additional units of coverage were exercised when needed. Each unit equals \$500,000 of coverage with a cost of \$60,000 each. As of December 31, 1998, the Company had paid for three units for a cost of \$180,000 and exercised the option on the forth unit. This unit was paid for in 1999.

The Company entered into an supplemental agreement with Swiss Reinsurance Company effective on December 31, 1998. This agreement stated that the Company shall purchase four additional units of reinsurance under the agreement with Signet Star Reinsurance Company. It extended the coverage provided from the loss portfolio agreement from \$12,000,000 to \$15,000,000. The liability of Swiss Re was not to exceed \$3,000,000. The premiums for this agreement were \$360,000. If the coverage remains loss free after seven years, this agreement will be commuted and 25% of the premiums paid shall be returned.

ACCOUNTS AND RECORDS

The Company's accounts and records consisted of a general ledger, journal, registers, statistical and other records normally maintained by a casualty insurance company. The Company used the services of a certified public accounting firm, to audit its accounts. A review was made of the audit reports and management letters prepared by the auditing firm for the years covered by this examination. The audit reports did not disclose any material exceptions to the amounts reported by the Company.

The Company provided an adjusted general ledger trial balance for the years covered by this examination. The adjusted trial balance for the year 1998 was reconciled to the financial statements contained in the 1998 annual statement.

Information provided by those responsible for maintaining the electronic data processing equipment and informational systems used by the Company, indicated that the business mission critical systems and non-critical applications were Year 2000 compliant.

A review of the Company's Drafts Outstanding list indicated that there were drafts with dates of 1991. Accordingly, the Company was not in compliance with the regulatory requirement for reporting unclaimed property contained in Utah Code Annotated (U.C.A.) § 31A-4-110.

FINANCIAL STATEMENTS

The financial statements included in this report are as follows:

Balance Sheet as of December 31, 1998

Statement of Income for the Year Ended December 31, 1998

Capital and Surplus Account from 1995 through 1998

The Notes to the Financial Statements are an integral part of the financial statements.

Wasatch Crest Insurance Company
BALANCE SHEET
As of December 31, 1998

ASSETS

	<u>Amount</u>	<u>Notes</u>
Bonds		
Cash & short term investments	\$ 3,982,298	(1)
Premiums and agents balances in course of collection (after deducting reinsurance ceded payable of \$420,000)	1,186,729	
Reinsurance recoverable on loss and loss adjustment expense payments	-418,005	(2)
Interest, dividends and real estate income due & accrued	730,016	
	<u>66,723</u>	
Total	<u>\$ 5,547,761</u>	

LIABILITIES, SURPLUS & OTHER FUNDS

Losses	\$ 4,557,206	
Reinsurance payable on paid losses and loss adjustment expenses	4,687	
Loss adjustment expenses	3,476,493	
Other expenses	15,887	(2)(3)
Amounts withheld or retained by company for account of others	109,895	
Provision for reinsurance	493,237	
Drafts outstanding	362,819	
Payable to parents, subsidiaries and affiliates	51,499	(3)
Aggregate write-ins for liabilities:		
Ceded balances payable	34,750	
Retroactive reinsurance reserve	<u>-7,890,290</u>	
Total Liabilities	<u>1,216,183</u>	
Aggregate write-ins for special surplus funds: Retroactive Reinsurance	6,340,396	
Common capital stock	2,250,000	
Gross paid in & contributed surplus	134,116,593	
Unassigned funds (surplus)	<u>-138,375,411</u>	
Surplus as regards policyholders	<u>4,331,578</u>	(4)
Total	<u>\$ 5,547,761</u>	

Wasatch Crest Insurance Company
STATEMENT OF INCOME
For the Year Ended December 31, 1998

Underwriting Income

Premiums earned		\$ -991
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Deductions

Losses incurred		2,055,497
Loss expenses incurred		2,897,328
Other underwriting expenses incurred		271,234
		5,224,059
Total underwriting deductions		5,224,059
Net underwriting gain or (-)loss		-5,225,050

Investment income

Investment income earned		281,621
Net realized capital gains		-1,313
		280,308
Net investment gain or (-)loss		280,308

Other income

Net gain or (-)loss from agent's or premium balances charged off		-534,973
Write-ins: Retroactive reinsurance gain		4,089,266
		3,554,293
Total other income		3,554,293
Net income or (-)loss before dividends to policyholders and federal income tax		-1,390,450
Dividends to policyholders		0
Federal and foreign income taxes		0
		0
Net Income or (-)loss		\$ -1,390,450

Wasatch Crest Insurance Company
RECONCILIATION OF CAPITAL AND SURPLUS ACCOUNT
From 1995 through 1998

<u>Description</u>	<u>12/31/95</u>	<u>12/31/96</u>	<u>12/31/97</u>	<u>12/31/98</u>
Surplus as regards policyholders prior year	\$ 13,583,999	\$ 14,408,451	\$ 14,064,159	\$ 5,526,158
Net income	279,419	-406,288	495,762	-1,390,450
Net unrealized capital gains	8,185	-1,145	-148	255
Change in non admitted assets	316,826	50,657	44,300	633,013
Change in provision for reinsurance	220,022	12,484	172,085	-437,398
Surplus adjustment: Paid in			-9,250,000	
Change in surplus	824,452	-344,292	-8,538,001	-1,194,580
Surplus as regards policyholders current year	<u>\$ 14,408,451</u>	<u>\$ 14,064,159</u>	<u>\$ 5,526,158</u>	<u>\$ 4,331,578</u>

NOTES TO FINANCIAL STATEMENTS

(1) Bonds

\$3,982,298

As of December 31, 1998, the Company's agreement with its investment custodian was not in compliance with Utah Administrative Code (U.A.C.) Rule R590-178. A new agreement was executed April 19, 1999. The new agreement was in compliance.

(2) Premiums and agents balances in course of collection

\$ -418,005

The Company entered into an agreement with Swiss Reinsurance Company on December 31, 1998. The premiums for this agreement were \$360,000. This amount was paid in 1999. The Company had exercised an option from Signet Star Reinsurance Company for a fourth \$500,000 unit for a cost of \$60,000. These amounts were shown in the liability for "Other expenses". They were reclassified to "Reinsurance balances payable" and included with "Premiums and agents balances in course of collection."

(3) Other expenses

\$15,887

Included in Other expenses were amounts due under the terms of a management agreement. These items were reclassified to "Payable to parents, subsidiaries and affiliates."

(3) Payable to parents, subsidiaries and affiliates

\$51,499

This amount was reclassified from "Other expenses."

(4) Capital and Surplus

\$4,331,578

For examination purposes, the Company's capital and surplus was determined to be \$4,331,578. The following schedule indicates the changes to the Company's accounts pursuant to examination findings:

	<u>Annual Statement</u>	<u>Examination</u>	<u>Surplus Change</u>	<u>Notes</u>
Premiums and agents balances	\$ 1,995	\$ -418,005	\$ -420,000	(2)
Other expenses	487,386	15,887	471,499	(2)(3)
Payable to Parents, subsidiaries and affiliates	0	51,499	<u>-51,499</u>	(3)
Total changes in surplus			0	
Capital and surplus per Company			<u>4,331,578</u>	
Capital and surplus per examination			<u><u>\$4,331,578</u></u>	

The Company's minimum capital requirement at December 31, 1998, was \$2,000,000. The authorized control level risk-based capital was \$1,136,370. The Company's total adjusted capital was \$4,331,578.

SUMMARY

The items of significance or special interest contained in this report are summarized as follows:

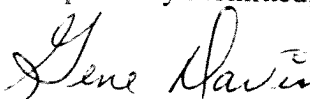
- (1) There was a change in control of the Company. (**AFFILIATED COMPANIES**)
- (2) Under previous management, the Company entered into a loss portfolio transfer agreement as a retroactive reinsurance contract. This agreement provided coverage up to \$12,000,000. The cost of this coverage was \$7,895,000. Options for additional units of coverage were exercised. The Company entered into an agreement with Swiss Reinsurance Company by which the Company shall retain \$12,000,000 of the ultimate net loss and Swiss Reinsurance Company shall extended the coverage provided from the loss portfolio agreement from \$12,000,000 to \$15,000,000. (**REINSURANCE**)
- (3) As of December 31, 1998, the Company's agreement with its investment custodian was not in compliance with U.A.C. Rule R590-178. However, a new agreement executed April 19, 1999, was in compliance. (**NOTES TO FINANCIAL STATEMENTS**)
- (4) Information provided by those responsible for maintaining the electronic data processing equipment and informational systems used by the Company, indicated that business mission critical systems and non-critical applications were Year 2000 compliant. (**ACCOUNTS AND RECORDS**)
- (5) The Company was not in compliance with the regulatory requirement for reporting unclaimed property contained in U.C.A. § 31A-4-110. (**ACCOUNTS AND RECORDS**)
- (6) The Company's minimum capital requirement at December 31, 1998, was \$2,000,000. The authorized control level risk-based capital was \$1,136,370. The Company's total adjusted capital was \$4,331,578. (**NOTES TO FINANCIAL STATEMENTS**)

CONCLUSION

The assistance and cooperation extended during the course of the examination by the officers, employees and representatives of the Company is acknowledged.

In addition to the undersigned, Mr. Dan Applegarth, CFE, Senior Financial Examiner, Mr. Faanu Laufiso, Financial Examiner and Mr. Brian Hansen, AIE, FLMI, CFE, Market Conduct Examiner, representing the Utah Insurance Department participated in the examination.

Respectfully submitted,



Gene Davis, CFE, CIE
Examiner-in-Charge
Financial Examiner
Utah Insurance Department